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Before The

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C.

In the Matter of	)	
	)	
Implementation of Sections of the	)	MM Docket No. 92-266
Cable Television Consumer	)	
Protection and Competition	)	
Act of 1992: Rate Regulation	)	

COMMENTS OF PROGRAMMING PROVIDERS

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COMMENTS OF PROGRAMMING PROVIDERS

New cable television programming networks, Ovation, Inc. and PBS Horizons Cable Network ("Programming Providers"), by their attorneys, respectfully submit the following comments on certain rules affecting the launch of cable television programming services. These comments are filed in response to the Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, FCC 94-38, MM Docket No. 92-266 (rel. March 30, 1994) ("Second Order on Reconsideration" and "Fifth Notice"). In its most recent rate orders, the Commission anticipated that its "cautious choice" toward programming incentives -- establishing a 7.5 percent markup over costs -- may be insufficient. Second Order on Reconsideration at ¶ 246 n.345. Consequently, the Commission indicated its intent to "carefully monitor the impact" of the permitted 7.5 percent markup on programming costs "to assure that it is fair to cable operators and subscribers," promising future revisions "if appropriate."

To obtain the necessary record the Commission opened a Fifth Notice of Proposed Rulemaking to examine various issues, such as the methodology the FCC should use when an operator provides more than 100 channels. The Fifth Notice also seeks comment on "whether our going-forward methodology should be modified to provide greater or lesser compensation to operators for adjustments to capped rates when channels are added or deleted from regulated tiers." Id. at ¶ 256.

While the Commission is properly concerned about creating adequate incentives for new programming services, the problems facing the Programming Providers extend beyond just the size of a price markup. Certainly the Commission should address this issue, and, as detailed below, it should do so as quickly as possible. The Commission must not await the demise of emerging programmers as part of the "full factual justification" it is seeking in the Fifth Notice of Proposed Rulemaking at ¶ 256. 1/ Additionally, the Commission must modify its rules more generally to remove uncertainty, reduce regulatory barriers and eliminate disincentives to the addition of new programming services. 2/ A variety of necessary steps are detailed below.

Immediate FCC action is imperative. Although it is clear that the Commission honestly sought to create incentives for new services, the most recent rules have had the opposite effect. Programming Providers already are beginning to feel the chill on channel expansion created by the rules. New networks that began negotiating with cable operators for distribution prior to release of the rules have found

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1/ The Commission should provide expedited consideration of the issues raised herein.

2/ Nothing in this request for expedited Commission action should be construed as reducing the need for immediate appeal of questions regarding the benchmark methodology as set out in the Emergency Motion of Time Warner Entertainment Company, L.P., For Expedited Consideration of Petitions For Review, No. 93-1723 (filed May 3, 1994). These comments relate solely to issues affecting incentives for adding programming services to a cable system and do not touch on benchmark calculations. Commission action on issues raised in this request is fully consistent with expedited appeal of questions regarding the benchmark methodology.

a dramatic change in operators' positions on planned launches since the regulations were released.

I. COMMENTERS ARE CONFRONTED WITH DECLINING OPPORTUNITIES FOR NEW PROGRAMMING SERVICES

During the past eighteen months, countless press reports have touted the blue-sky potential of the "Electronic Superhighway" and the 500-channel universe. Once that world of tomorrow arrives, it may be much easier for a new programming service to find available channel capacity and obtain carriage. But that world is not here yet, and even when it arrives, it will be necessary for operators to have a financial incentive to carry new services. Many promising and innovative services will not survive the difficult transition period. The only hope for these programmers is for the Commission to find ways to create incentives for their carriage on cable systems as they exist today.

A. PROGRAMMING PROVIDERS

Programming Providers represent new and emerging cable television programming services. Although Programming Providers plan to compete vigorously with one another in the marketplace for carriage commitments and viewers, they have one thing in common: Success will be difficult or impossible if the Commission does not modify its regulations to provide greater incentives for expanded channel capacity and new programming services. Press accounts suggest that as many as seventy new cable programming services are scheduled to launch within the next year. 3/ As with Programming Providers, the viability of these new services will depend upon revision of

3/ *See* Christopher Stern, *Programmers*, Broadcasting & Cable, April 11, 1994, at 51; Elizabeth Kolbert, *A Turner Channel Seeks Carriers*, New York Times, April 11, 1994, at D5.

the rules to provide proper incentives for operators to add new channels of programming. Programming Providers include:

1. **OVATION, INC.** Ovation is a new cable television network dedicated to the fine arts -- drama, dance, jazz, opera, classical music, literature, profiles, museums and other visual arts. Ovation plans to begin satellite delivery of high quality performing and visual arts programming near the end of 1994. The network plans to be offered free to operators as an advertiser-supported basic service where possible and as a premium or à la carte service elsewhere.

2. **PBS HORIZONS CABLE NETWORK.** Public Broadcasting Service, WGBH Boston and Thirteen/WNET New York are planning to expand the reach of public television with the launch later this year of a new cable service, PBS Horizons Cable Network. This new 24-hour cable channel will broaden the range of educational programming available in this country by carrying a variety of material, including readings, lectures, debates and symposia from universities, museums, libraries and art centers. PBS Horizons Cable Network plans to charge cable operators a relatively low fee to carry its programming, and to be primarily advertiser supported. Cable operators will have the option of providing PBS Horizons Cable Network free of charge to schools, libraries, museums, prisons, nursing homes and other public institutions in their service areas.

B. THE FCC'S RULES HAVE RESTRICTED OPPORTUNITIES FOR NEW PROGRAMMING SERVICES

As potential new services seek investors and discuss the prospects for carriage with cable operators, they generally receive a single response: investment and expansion plans are being postponed until the detrimental effects of the FCC's cable rate regulations have been sorted out. Moreover, unless and until these effects are alleviated by further Commission action, few, if any, new networks will go forward in a meaningful way. All new channels of programming are in danger of being derailed by the new regulations. A number of start-up networks have already delayed their launches because of the uncertainties created by the new rules. For example, Golf Channel, World African Network, Planet Central, Parasol 4, Recovery Network, FIT, Booknet, Romance Classics and CNN International have postponed launches. 4/ Many have predicted that new networks that have been forced to delay launches will not have the "deep pockets" required to survive until next year. 5/ Even networks that had contracts in place with established launch dates have agreed to postpone launches in the face of the regulatory environment created by the FCC's new rules. 6/

The uncertain environment created by the rules has led to industry-wide decisions to freeze plans to add new channels of programming. 7/ Cable operators perceive that the new rules have put them in a "straightjacket," preventing them from adding new channels until problems and uncertainties regarding the new rules are finally resolved. 8/ Operators are reluctant to follow through with plans to add channels of programming because the financial incentives provided by the new rules are so "skinny." 9/

4/ *See* Kim Mitchell & Rod Granger, *Operators Give New Networks Little Attention*, Multichannel News, March 7, 1994, at 3.

5/ Id.

6/ *See* Kim Mitchell, *Multimedia Tries to Talk Way Into Ops' Line-ups*, Multichannel News, March 14, 1994, at 10.

7/ Id.

8/ *See* Elizabeth Kolbert, *A Turner Channel Seeks Carriers*, New York Times, April 11, 1994, at D5; Alan Breznick, *Nets Checkmate?* Cable World, March 28, 1994, at 36; Alan Breznick, *Network Wannabes Press on Despite Dour Launch Outlook*, Cable World, April 11, 1994, at 1, 50.

9/ *See* Christopher Stern, *Programmers*, Broadcasting & Cable, April 11, 1994, at 51.

From the cable operators' perspective, the FCC's new rules discourage the addition of new channels of programming to regulated tiers because they fail to provide adequate incentives for program additions. 10/ However, adding programming to an unregulated, à la carte package is also problematic because the new guidelines discourage moving existing channels of programming to an à la carte package. Even if the new rules did not discourage à la carte packaging, the prospect of being launched in an à la carte package versus a regulated tier of service is far less attractive to a new network. It would be difficult for smaller networks to survive a launch in an à la carte package under the FCC's existing rules. A recent report by Saatchi and Saatchi Advertising predicts that brand-name and niche programmers will be most at risk to be shuttled into relatively low-penetration à la carte packages where advertising revenues will be correspondingly low. 11/ The report also predicts that some cable networks "may go out of business, and others merge" based on the impact of the new rules. 12/

These accounts of the general state of the industry are borne out by Programming Providers' and others' experiences. Some of the pressing problems confronting programmers can be dealt with through clarifications, and the Commission

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10/ Id.

11/ *See* Saatchi & Saatchi Report, attached as Exhibit 1; Linda Moss, *Re-Regulation May Spark Shakeout, Saatchi Says*, Multichannel News, April 25, 1994, at 34.

12/ Id.

has demonstrated its willingness to resolve these problems, where possible. 13/ But rule clarifications are not enough to enable most new networks to get off the ground. There will be little or no opportunity for new networks to increase penetration unless the incentive structure is changed. Given the significant disincentive for operators to add new services, coupled with the inadequate incentives to add programming, many operators are simply unwilling to increase channels on their regulated tiers of service.

The prospect that this dire prediction is true is particularly troubling to programmers like Ovation and PBS Horizons Cable Network, who do not have carriage agreements in place. Prior to issuance of the new regulations, Ovation had contacted many cable operators to discuss its launch. *See* Declaration of Edward Burakowski, attached as Exhibit 2. Reaction was very favorable, and Ovation planned to have signed affiliation agreements with a number of major cable operators before the NCTA Convention this month. Id. Operators put affiliation plans on hold, however, after release of the new rules. Id. The primary problems identified by cable operators with the rules are the 7.5 percent markup is not an adequate incentive to add new programming and the extent to which upgrade costs may be recovered is uncertain. Id. PBS Horizons Cable Network has had the same experience, having been told by many operators that plans for channel additions are on hold for at least a year. *See* Declaration of Diane Asadorian, attached as Exhibit 3; *see also* Exhibit 4.

13/ *See e.g.,* Letter from Alexandra M. Wilson to Robert Corn-Revere dated April 14, 1994; Letter from Alexandra M. Wilson to Robert Corn-Revere dated April 19, 1994; Letter from Alexandra M. Wilson to Robert Corn-Revere dated May 6, 1994; Letter from Alexandra M. Wilson to Peter H. Feinberg, dated May 6, 1994; Letter from Alexandra M. Wilson to Sue D. Blumenfeld, dated May 6, 1994. Recent launches that were facilitated by FCC clarifications do not solve other networks' problems. As one operator noted, fX will be "the last one that squeaks through." *See* Richard Katz, *fX Claiming Record Launch; Unveils Sked,* Multichannel News, April 25, 1994, at 3.

II. THE COMMISSION MUST MODIFY ITS RATE REGULATIONS IF IT IS TO FULFILL THE STATUTORY PURPOSE OF PROMOTING PROGRAMMING DIVERSITY

In passing the 1992 Cable Act Congress intended to "promote the availability to the public of a diversity of views and information through cable television," and to "ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems." 14/ The Commission expressed its intention to fulfill this statutory purpose when it adopted the "going forward" methodology. It stated that "a goal of our 'going forward' methodology is to allow cable operators to grow and develop new facilities and services, including new and innovative regulated programming services." 15/ But to the extent the FCC's rules discourage operators from adding new programming, they undermine fundamental legislative goals as well as the Commission's intentions. The Commission must therefore act quickly to prevent the irretrievable loss of the values it sought to promote.

A. The FCC Must Insure That Its Rules Provide Adequate Incentives for Cable Operators To Add New Channels of Programming

In adopting its going forward rules, the Commission clearly intended to encourage investment in new services. Unfortunately, the means chosen -- the 7.5 percent solution -- falls far short of its intended purpose. 16/ This percentage-based

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14/ 47 U.S.C. § 521(b)(1), (b)(3). Of the five legislative goals articulated by Congress, four related specifically to programming and diversity issues. Id.

15/ Second Order on Reconsideration at ¶ 238.

16/ The methodology includes a pass-through of network licensing fees adjusted upward by 7.5 percent plus an adjustment to cover channel changes based on the number of regulated channels and the number of channels added to -- or deleted from -- a given tier. In most cable systems, this channel change adjustment amounts to one cent per additional channel. This adjustment has been uniformly criticized in the industry as being utterly inadequate. For example, it would take more than two years for this adjustment to cover the postage costs associated with notifying subscribers of a channel change. Accordingly, where these Comments discuss the adequacy of

[Footnote continued]

approach will not promote the addition of new services and actually creates a number of perverse incentives: operators are encouraged to add more expensive networks or to replace lower-priced services with those that cost more, and programmers are given an incentive to raise their prices.

First, it is important to understand that a mere 7.5 percent markup on the amount of a cable network's licensing fee provides no realistic incentive to add a channel. For example, where the network fee is a relatively low (but not atypical) tier rate of 7 cents per subscriber, the cable system would be allowed to mark up the license fee by only $.00525. This would not begin to cover the launching and marketing costs of a new service. 17/ This miniscule markup declines even further with less costly channels, to the point that there is no incentive whatsoever for programming offered to an operator free of charge (as with advertiser supported channels). Obviously, if there is no cost to the cable operator, there is no cost to be passed through, nor is there any cost to mark up.

The incentive to add free or low-priced channels is further diminished by the required subtraction from external cost pass-throughs for costs of channels deleted, plus the 7.5 percent markdown for those channels. 18/ Therefore, if a cable operator does not have sufficient channel capacity to add a new channel of programming without also deleting an existing channel, the channel to be deleted must be lower-priced than the one being added, or the channel addition will require an overall reduction in rates.

[Footnote continued]

programming incentives, references to the markup amount will tacitly include the channel change adjustment as part of the incentive structure that must be reformed.

17/ Declaration of Edward J. Burakowski, attached as Exhibit 2.

18/ *See* 47 C.F.R. § 76.922(d)(3)(xi).

This rate structure unfairly discriminates against low-priced channels of new programming, and protects entrenched, higher-priced programming services. The operator is encouraged by the rules to maintain an existing service even if it and its viewers would vastly prefer to use the limited channel capacity for an existing new (and even free) network.

Following this reasoning, any incentives that may be created by the 7.5 percent markup are antithetical to the Cable Act and the Commission's stated intentions. The regulatory tilt toward higher-priced channels has already led to the replacement of lower-priced services, such as C-SPAN, from many cable systems. Approximately 2.5 million subscribers have lost some or all of their access to C-SPAN since rate regulations went into effect last year. Since the most recent rules were announced, that network has lost an additional 200,000 subscribers. 19/ This unfortunate result is inevitable to the extent the Commission's rules fail to create incentives for operators to expand capacity, but instead encourage operators to cannibalize existing basic services. 20/ The rules create a further incentive to use spare capacity for unregulated services, rather than for basic or enhanced basic networks. 21/ But the choice of allocating channels between regulated and unregulated

19/ Christopher Stern, *FX Factor: C-SPAN Minus 200,000 Subs*, Broadcasting & Cable, May 9, 1994, at 53; Rod Granger, *Lamb Details Plex Plans*, Multichannel News, March 14, 1994, at 10.

20/ Petitioners are not suggesting that any particular channel is more meritorious than another. It was the intention of Congress that there be room for all and that subscribers' choices would be enhanced. Subscribers should have access to both fX and C-SPAN, as well as Ovation, PBS Horizons Cable Network and all other new services. But the current incentive structure thwarts the achievement of this goal.

21/ Replacing an inexpensive network from basic service makes economic sense under the current rules. "One MSO executive mentioned a 100,000-subscriber system that replaced a five-cent network with a pay channel that he pushed to 5 percent penetration. The system would lose $84,000 in revenue, but make $250,000 in profit on the pay service." Higgins & Granger, *Small Nets, Big Problem?* Multichannel News,

[Footnote continued]

tiers should be based on consumer choice, editorial policy and business judgment -- not artificial regulatory pressures. 22/

The Commission should adopt an alternative to the percentage-based markup to cure the current disincentives to add free or low-priced programming and to provide a meaningful level of incentive. 23/ For example, cable operators could be given the option to choose either a specified percent markup or a flat fee above programming costs (e.g., 25 cents) for each new channel of programming, whichever is higher. 24/ Under this proposal, a cable operator would be able to pass-through 25

[Footnote continued]

April 25, 1994, at 1. *See also* Kim Mitchell & Rod Granger, *Operators Give New Networks Little Attention*, Multichannel News, March 7, 1994, at 3; Ted Hearn, *Nervous Cable Programmers Hope for Best From FCC*, Multichannel News, March 7, 1994, at 25. The Commission expressly acknowledged this effect of its rules, noting that "while investment could initially be adversely affected by the reductions in the cash flows generated by current regulated services, many operators will have opportunities to generate steadily increasing cash flows from unregulated services." Second Order on Reconsideration at ¶ 59 (emphasis added).

22/ Another possibility is that the percentage-based incentive structure could cause programming networks to increase their licensing fees in order to increase the size of operators' pass-throughs. Such a result would drive prices up, and clearly is not a result that Congress or the Commission intended. Most programmers, however, do not have the leverage it would take to increase prices at will. If anything, the new rules have increased operators' bargaining power vis-à-vis programmers. *See* Alan Breznick, *Nets Checkmate?* Cable World, March 28, 1994, at 36. This is precisely the opposite of what Congress intended. *See* 47 U.S.C. § 521(b)(5).

23/ Commenters acknowledge that for some networks, a percentage-based markup might provide a realistic incentive. Consequently, the Commission could reasonably decide to retain some type of percentage-based formula, but only if it is combined with a solution for low-priced or free networks.

24/ Programming costs should not be limited to the licensing fee, but should include any unreimbursed cost associated with the launch of a channel. The Commission also [redacted] cents plus costs, regardless of whether the new channel is free to the operator or includes a licensing fee. This approach would eliminate the incentive for cable operators to add only the most expensive channels. 25/

In addition, the 7.5 percent markdown for programming deleted from a tier should be eliminated. This markdown requirement serves only to entrench existing, high-priced services at the expense of new, lower-priced services, regardless of merit and viewer preferences. The Commission evidently was concerned that operators would game the process by deleting more expensive channels and substituting less expensive ones, increasing their profit margins without concern for subscriber preferences. However, the incentives created by the new rules overcompensate for this concern and penalize operators who replace high-cost channels with low-cost ones for sound editorial reasons. If anything, the Commission's concern in this area reinforces an existing bias in favor of higher-priced channels. The markdown requirement serves only to reduce the incentive to provide new services to cable subscribers.

To the extent the Commission chooses to adopt some form of flat fee approach, it must select an amount that balances the needs of programmers with the interests of consumers. From the programmers' perspective, the markup must be sufficient to provide the incentive for operators to add their service to a regulated

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25/ To the extent the Commission believes a compelling reason exists to limit such relief, it could consider establishing an "incubation period" for new services. One possible approach is to allow the 25-cent markup for the first two years after launch of a network, or until the network provides service to 15 million subscribers -- whichever comes first -- and 15 cents thereafter for three years, or until the network reaches 30 million subscribers. Any such incubation period must be carefully considered, however, to avoid creating an incentive to churn channels continuously.

tier. 26/ From the consumer's perspective, the amount should not be so large that it exceeds the value of the added service. With these objectives in mind, a 25-cent markup would be reasonable. Where "basic" cable services are available in an openly competitive market, subscribers typically pay fees of several times the proposed markup for a given network. 27/ In this context, a 25-cent markup is a reasonable accommodation of the various interests involved. However, the Programming Providers acknowledge that a range of solutions could be reasonable, to the extent they provide an adequate incentive and have some basis in real world business requirements.

B. The FCC Must Eliminate Rules That Discourage the Addition of New Networks

1. The Commission's Complaint Procedures Unreasonably Penalize Adding New Services

The FCC's procedural rules create a special disincentive to the addition of new programming services. Regulation of cable programming services by the FCC is a complaint-driven process, and the Commission may act only when it receives a valid subscriber complaint. At the same time, the Cable Act specifically limits the time in which a complaint may be filed to a "reasonable period of time" following a rate

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26/ In this regard, programmers may not be in the best position to determine what amount is sufficient to be an incentive for operators. However, a figure that approximates market-based pricing should provide an adequate incentive.

27/ The home satellite dish market is fully competitive, with a wide variety of possible programming providers who compete for customers on the basis of price. Although there are differences between the cable and home dish markets, it is revealing to note that "basic" channels normally are marketed at prices ranging from 45 cents per month to 2 dollars or more per channel. *See* Exhibit 5, attached. Despite the differences in the two markets, these prices provide insight into the value subscribers place on basic services. By comparison, a 25-cent markup is conservative. Such a markup also is reasonable when measured by the Commission's previous per-channel benchmark approach. Based on its survey of cable rates, the Commission found the rate per channel in most cable systems was in the 50-cent range.

increase. However, the Commission has ruled that any change in rates that may accompany a channel addition makes an operator subject to complaints regarding its entire rate structure, not just the amount of the increase. This interpretation creates an extremely powerful disincentive to add new channels and is contrary to the Cable Act.

The 1992 Cable Act requires that complaints be filed within a "reasonable period of time" after a rate increase. 47 U.S.C. 543(c)(3). In a Section entitled "Limitation on Complaints Concerning Existing Rates," the Act provides that "[e]xcept during the 180-day period following the effective date of the regulations prescribed by the Commission, . . . [jurisdiction over complaints] shall be available only with respect to complaints filed within a reasonable period of time following a change in rates." 47 U.S.C. § 543(c)(3). Consistent with this statutory language, the FCC's rules provide a window for filing complaints directed at rates for cable programming services as of the effective date of rate regulation (September 1, 1993). The cable programming service complaint window was open for six months after the effective date of the rate regulations. 47 C.F.R. § 76.953(a). After the expiration of the six-month period (on February 28, 1994), complaints are permitted only if an operator changes its rates. 47 C.F.R. § 76.953(b). Complaints directed at a rate increase must be filed within 45 days of receipt of the first bill reflecting the rate increase. Id. Even though the window for filing complaints against existing cable programming service rates expired on February 28, 1994, six months after the effective date of regulation, the Commission has ruled that a complaint filed after a rate increase opens all cable programming service rates up to scrutiny, not just the portion of the rates attributable to the rate increase. 28/

28/ Report and Order and Further Notice of Proposed Rulemaking, FCC 93-177, MM Docket No. 92-266, ¶ 375, n.907 ("Rate Order"); News Release, Mim. No. 41723, released Feb. 9, 1994. For example, if a cable system has never had a complaint filed with the FCC regarding its cable programming service rates, by adding a channel and passing through to subscribers the cost of adding the channel, the operator will open its entire rate structure for cable programming services to scrutiny. If a complaint is filed

[Footnote continued]

This interpretation providing for the reopening of the otherwise closed window for rate complaints is contrary to the statutory requirement that rates may be challenged only within a "reasonable" period of time. It is also at odds with the Congressionally mandated 180-day limitation period for the filing of complaints with respect to rates in effect on the initial date of regulation. *See* 47 U.S.C. § 543(c)(3).

The legislative history of the 1992 Cable Act is replete with indications of Congress' intent to limit the period of time in which a rate may be challenged to a certain, defined period to prevent stale complaints. The legislative history plainly states that "[t]he FCC may act only upon a complaint that is filed within a reasonable time after a rate increase . . .". S. Rep. 102-92, 102d Cong., 1st Sess., at 74 (emphasis added). The legislative history of the Act is clear: "After six months following the effective date of the Commission's regulations, complaints may be filed only within a reasonable period following an increase in the cable rates." Cong. Rep. 102-628, 102d Cong., 2d Sess., at 87. The language of the Act -- which provides for a deadline for challenges to rates in effect on the effective date of the regulations -- is consistently supported in the legislative history: "[e]xcept for the period before 180 days after the effective date of the Commission's regulations, complaints may be filed only within a reasonable time following a change in rates." Conference Report, Cong. Rep. 102-862, 102d Cong., 2d Sess., at 61.

[Footnote continued]

with the FCC during the 45-day window after the rate increase, the FCC may examine not only the amount of the increase, but the pre-existing rate as well. The FCC acknowledges that it is barred by statute from requiring refunds for a September 1, 1993 rate that was not challenged during the 180-day period after September 1, 1993. Rate Order at n.907. However, the Commission concludes that it may act prospectively to require reduction of a September 1, 1993 rate based on a complaint filed after expiration of the 180-day period if the complaint is filed with respect to a rate increase. Id.

The FCC's current rule permitting a complaint based on a rate increase to reopen the entire rate structure to scrutiny poses a very real threat to new programming services. Where the mere addition of a channel subjects all tiered rates to regulatory analysis by the FCC, cable operators will be deterred from adding any channels (and passing through the cost of those channels). 29/ Under this scenario, it is not only possible, but likely that all channel additions, as well as adjustments for inflation and other external cost pass-throughs, will be delayed for as long as possible by cable operators, who will strive to postpone challenges to their cable programming service rates. This procedural anomaly will be fatal to new programming networks, which will never be able to plan a launch date. 30/

To cure the problem caused by the re-opening of the rate complaint window based on a channel addition, the FCC must adopt a rule, consistent with the statute, that the complaint window for channel additions and rate increases is limited to a review of the increased rate. The FCC should make clear that where an operator's September 1, 1993 rates were never challenged, the statutorily prescribed February 28, 1994 deadline is in force. Any complaints filed after February 28, 1994 in response to a rate increase should be reviewed only with respect to the reasonableness of the increase.

29/ In weighing the disincentive to add a new network, the operator's legal costs from an overall rate proceeding could themselves far outweigh the financial incentive associated with the addition.

30/ *See* Kim Mitchell & Rod Granger, *Operators Give New Networks Little Attention*, Multichannel News, March 7, 1994, at 3; Elizabeth Kolbert, *A Turner Channel Seeks Carriers*, New York Times, April 11, 1994, at D5

2. Local Franchise Authorities Should Not Be Permitted To Delay Approval of External Cost Pass-Throughs

Under current rules, regulated cable systems are subject to local franchise approval before they can pass-through the cost of adding a channel of programming to basic service. Although the FCC characterizes the pass-through of these costs as "automatic," it also provides that local franchise authorities may approve or disapprove of automatic pass-throughs. The Commission begins with the assumption that "certain [exogenous costs] can automatically be passed through to subscribers . . .". "However," the Commission continues, "a franchising authority, in order to regulate rates effectively, must be apprised of such automatic adjustments in order to ensure that they are accurately calculated and justified." The Commission concludes that, "[b]ecause such exogenous costs are presumed reasonable, review of these adjustments should not create an undue delay for the operator, and the franchising authority must pass on them within 30 days." Rate Regulation Order at ¶ 133 (footnotes omitted).

The FCC should expeditiously clarify the timing of pass-throughs of external costs for the addition of programming to the basic tier. The statutory language clearly provides that cable operators must give 30 days' notice prior to a rate increase. 47 U.S.C. § 543(b)(6). There is nothing in the statute to suggest that prior approval from the franchise authority is required before a rate increase may take effect. Accordingly, the FCC has the flexibility to revise its rules to eliminate the requirement for prior approval of a rate increase by a regulated system's franchise authority.

Without a rule revision, a local franchise authority may inordinately delay a proposed pass-through, while the cable operator (or programmer) must absorb the amount of the increase with no possibility of ever recovering it. Although the Commission discusses the 30-day "deadline," the staff has interpreted this to mean that external cost pass-throughs are treated the same as full-blown rate review proceedings, where franchise authorities may take up to 150 days to consider a proposed rate increase on a Form 1210, 47 C.F.R. § 76.933(b), or 180 days to consider a proposed increase based on a cost-of-service analysis. Id. If the external cost pass-through has not been approved within the allotted time period, the franchise authority must allow the new rate to take effect, but may issue an accounting order to extend refund liability based on the pass-through for up to a year, if the franchise authority ultimately disapproves of the rate change. 47 C.F.R. § 76.933(c). The FCC staff has encouraged franchise authorities to complete their review of proposed pass-throughs within 30 days, 31/ but operators have no assurances that this will occur.

The potential for such lengthy delays will deter operators from adding any new programming channels to the basic tier, again fortifying the position of existing networks at the expense of new networks. Neither cable operators nor programmers will be willing carry the costs of a new channel of programming for a period of up to five or six months with the possibility that the pass-through may not ultimately even be approved.

Since many franchise authorities meet only once a month, it would not be unreasonable to assume that even the most routine pass-throughs could take several months to obtain franchise approval. Rate increases are approved only prospectively. Each month that the pass-through of programming cost increases plus the 7.5 percent markup is delayed means that the operator will lose 1/12 (8.3 percent) of the year's revenues from that pass-through. Thus, even a one-month delay more than eliminates the 7.5 percent markup. During the period of time that a franchise authority is considering whether or not to approve a pass-through of programming costs, the operator's out-of-pocket costs of carrying the programming, not to mention the amount of the 7.5 percent markup, are lost forever.

31/ *See* Letter from Alexandra M. Wilson to Robert Corn-Revere, April 14, 1994.

The rules should be revised to provide that external costs may be passed through automatically 30 days after notification to the franchise authority, subject to refund liability. Franchise authorities should not be permitted simply to adopt a tolling order to delay the effectiveness of the pass-through as they are permitted to do under Sections 76.933(b) and 76.933(c) of the Rules with respect to existing rates. If the franchise authority ultimately determines that the external cost pass-through is unreasonable within 30 days after the cable operator gives notice of the rate increase, it may prevent the increase. If, within the time frames set forth in Sections 76.933(b) and (c) of the Rules, the franchise authority disapproves of the rate increase, it may order refunds on the amount of the increase. By permitting the pass-through to take effect automatically after the statutorily required 30-day notice period, the Commission will eliminate delay in cost recovery for cable operators while retaining the safeguard of franchise approval of the pass-through.

3. À La Carte Guidelines Must Be Clarified To Permit Flexibility In The Offering Of Per Channel Packages

a. The Guidelines Must Be Fair To Existing Programming Services And Provide Opportunities For New Programmers

The Cable Act of 1992 strongly endorses the provision of à la carte services as a means of increasing subscriber choice in the purchase of cable services. 32/ The Commission's policies in this area, however, will have a profound effect on both new and existing cable program services. Existing program networks, with large subscriber bases and a dependency on advertising revenue, are justifiably

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32/ Indeed, the Senate Report stated that "one of the prime goals of the legislation in to enhance subscriber choice. Unbundling [of program services] is a major step in this direction. Cable operators and programmers are urged to work toward this objective." S. Rep. No. 102-92, 102d Cong., 2d Sess. (1992).

concerned that a sudden shift to à la carte status would degrade the economic basis of their service. At the same time, new programmers are justifiably concerned that they will not have the opportunity to achieve widespread penetration if they are singled out for à la carte treatment. Unfortunately, the Commission's current à la carte policy may be the worst of both worlds for both existing and new networks.

In its first Report and Order, the Commission struck a balance that permitted à la carte channels to be grouped in "packages" that resembled tiers so long as subscriber interests were protected. In particular, the à la carte packages were required to offer consumers a realistic service choice in the purchase of cable services. The balance struck by the Commission was important to allow established services to maintain existing penetration levels while at the same time giving subscribers more choice and permitting new services to be grouped with established entities.

In the Second Order on Reconsideration, the Commission articulated 15 factors that it will use to evaluate whether an à la carte package should be treated as a regulated "tier" of service. The FCC has not yet issued any decisions based on the new à la carte guidelines and it is unclear how the FCC will evaluate a given à la carte structure. However, it seems clear that the guidelines discourage operators from offering existing networks in a new à la carte package or grouping some existing services with new networks in an à la carte package. This uncertain status is harmful to both existing and new programming services.

One of the factors that the FCC has identified as an indication that an à la carte package should be regulated is the movement of channels of programming from a regulated tier to an à la carte package. Second Order on Reconsideration at ¶ 196. By discouraging operators from moving established services from tiers to à la carte packages, the FCC has inadvertently created a "glass floor" for new services. This will motivate cable operators to retain established services in existing regulated tiers of service while relegating new, untested programming services to à la carte status. This will drive up marketing costs for new services to prohibitive levels and limit their opportunities for success. 33/ Another option that appears to be open is for operators to eliminate all tiers of service and make all of their non-basic channels à la carte. This structure would penalize both existing tiered channels (by compromising their penetration and dissipating advertising revenues) and new channels (which will have difficulty gaining exposure to viewers unless packaged with other, established services). When reevaluating the à la carte guidelines, the FCC must build in flexibility to enable operators to reasonably market existing networks as an à la carte package or to group old and new services to ensure that all services achieve the maximum possible exposure to viewers. 34/ There is no statutory impediment to encouraging existing channels to be offered in an à la carte package. Indeed, as part of its strong endorsement of unbundling of programming services, Congress acknowledged the need to "nurture certain offerings or help market them to expose them to more subscribers. For example, the television networks carry this out by placing a new program between already highly rated shows." 35/

33/ Marketing costs for new channels to attract subscribers to their à la carte positions will be prohibitively high. *See* Christopher Stern *Programmers*, Broadcasting & Cable, April 11, 1994, at 51 ("[a]n à la carte launch is particularly difficult for a young network without deep pockets because it requires a large marketing campaign to build consumer awareness and demand.") It will also be difficult to attract advertising dollars to a package of untested services with no guaranteed penetration level. *See* Saatchi and Saatchi Report, Exhibit 1.

34/ Nothing in the Commission's rules should affect the ability of program networks to enforce à la carte limitations in existing affiliate contracts.

35/ S. Rep. No. 102-92, 102d Cong., 1st Sess., at 77. The Commission's focus on whether a given à la carte package should be treated as a regulated tier should be evaluated in light of current practices of satellite programming distributors. À la carte packages are the primary vehicle for program offerings among unregulated satellite programming distributors. *See* Exhibit 5.

To eliminate the current discriminatory effect of the new à la carte guidelines on programming networks, the guidelines should be clarified to permit operator discretion in the creation of à la carte packages. Such a clarification should endorse the inclusion of both established and start-up networks in à la carte packages. This will reduce cable operators' reluctance to move established "anchor tenant" networks out of regulated tiers, providing "brand name" networks to attract subscribers to à la carte packages. It is critical that any ruling be issued expeditiously to limit the adverse impact of the current rules on new and existing programming services.

b. The FCC Must Retain Jurisdiction Over À La Carte Decisions

The most important impediment to the development of a coherent à la carte policy is the current level of uncertainty regarding permissible à la carte practices. The Commission has compounded this problem by deciding to share decisionmaking with local authorities. However, the FCC is required by statute to retain jurisdiction over à la carte decisions.

The jurisdiction of local franchises is precisely defined by the 1992 Cable Act, which not only limits local franchise authorities' jurisdiction over rates to those for basic service, 47 U.S.C. § 543(a)(2)(A), but also requires franchise authorities to take steps to become qualified to regulate basic rates and obtain certification from the Commission. Id. Thus, the Commission's discretion to confer jurisdiction on rate issues to local franchise authorities is very narrow.

The Act bestows exclusive jurisdiction over cable programming rates on the Commission. 47 U.S.C. § 543(c). If deemed to be regulated, à la carte packages are tiers of cable programming services, not basic services. 36/ The Commission

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36/ The FCC implies that there may be situations where an à la carte package may be deemed to be a regulated basic tier. Second Order on Reconsideration at ¶ 197. However, the "basic" tier is defined by statute as "a separately available basic service

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plainly acknowledges that local authorities may decide whether à la carte packages are subject to regulation "even if the tier would be a cable programming services tier." Second Order on Reconsideration at ¶ 195 n.262. *See also* id. at ¶ 197. It attempts to justify its unauthorized delegation of jurisdiction over à la carte decisions to local franchise authorities on the basis that, if deemed to be regulated, à la carte channels will affect the permissible rate for basic service. This position is inconsistent with the express language of the Act, which carefully defines the very limited circumstances in which local franchise authorities may assume jurisdiction over rates. If the Commission's logic were sound, then franchise authorities would also have jurisdiction over all other aspects of cable programming services on the theory that rates for cable programming services affect basic rates. Plainly, this was not the intent of Congress.

The FCC clearly exceeded its authority under the Act when it delegated to local franchises decisionmaking power over à la carte issues. When Congress delegates to an agency jurisdiction over the implementation of a law, the agency may not, in turn, delegate that jurisdiction to another entity in the absence of express statutory authority to do so. Planned Parenthood Federation of America, Inc. v. Heckler, 712 F.2d 650, 663 (D.C. Cir. 1983). 37/ The FCC has even recognized its lack of discretion to delegate jurisdiction over cable programming service rates. In its first rate order, the Commission expressly noted that it was

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[Footnote continued]

tier to which subscription is required for access to any other tier of service." The statute also prescribes the minimum contents of the basic tier, including must-carry and PEG channels. 47 U.S.C. § 543(b)(7). An à la carte package -- even if deemed to be a regulated tier of service -- could not be mistaken for a "basic" tier.

37/ *See also* Vierra v. Rubin, 915 F.2d 1372, 1378 (9th Cir. 1990) (agency's authority to delegate decisionmaking power is limited by statute); Jackson v. Rapps, 947 F.2d 332, 336-37 (8th Cir. 1991) (same).